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Committee of Experts on International Cooperation in Tax Matters
Fifth session
Geneva, 19-23 October 2009

Provisional agenda and organization of work

1. Opening of the session by the representative of the Secretary-General (closed meeting).
2. Election of the Chairperson and the Rapporteur of the Committee and other officers (closed meeting).
3. Consideration of rules of procedure and other organizational issues (closed meeting).
4. Introductory remarks by the Chairperson of the Committee.
5. Adoption of the agenda and organization of work.
6. Discussion of substantive issues related to international cooperation in tax matters:
   (a) Definition of permanent establishment;
   (b) Taxation of services, including royalties and technical fees: policy and technical issues;
   (c) Attribution of profits under article 7 of the United Nations Model Double Taxation Convention between Developed and Developing Countries;
   (d) Taxation of development projects;
   (e) Tax competition in corporate tax: tax incentives that have worked and not worked in attracting foreign direct investment;
   (f) The proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance;
   (g) Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries;
   (h) How treaties are developed: practical issues;
   (i) Dispute resolution;

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(j) General issues in the review of commentaries of the United Nations Model Double Taxation Convention between Developed and Developing Countries;

(k) Transfer pricing, including a manual and checklist for developing countries.

7. Dates and agenda for the sixth session of the Committee.

8. Adoption of the report of the Committee on its fifth session.

Organization of work

Date	*Item*	*Description*
Monday, 19 October 2009		
9-10 a.m.		Registration of participants
10-10.40 a.m. (closed meeting)	1	Opening of the session by the representative of the Secretary-General
	2	Election of the Chairperson and the Rapporteur of the Committee and other officers
	3	Consideration of rules of procedure and other organizational issues
10.40-11 a.m. (open meeting commences)	4	Introductory remarks by the Chairperson of the Committee
	5	Adoption of the agenda and organization of work
	6	Discussion of substantive issues related to international cooperation in tax matters:
11 a.m.-1 p.m.	6 (a)	Definition of permanent establishment
3-5 p.m.	6 (a)	(*continued*)
5-6 p.m.	6 (b)	Taxation of services, including royalties and technical fees:
		policy and technical issues
Tuesday, 20 October 2009		
10-10.30 a.m.		Report of the rapporteur on item 6 (a)
10.30 a.m.-12 noon	6 (b)	(*continued*)
12 noon-1 p.m.	6 (c)	Attribution of profits under article 7 of the United Nations Model Double Taxation Convention between Developed and Developing Countries
3-5 p.m.	6 (c)	(*continued*)
4-5 p.m.	6 (d)	Taxation of development projects
5-6 p.m.	6 (e)	Tax competition in corporate tax: tax incentives that have worked and not worked in attracting foreign direct investment
Wednesday, 21 October 2009		
10-10.30 a.m.		Report of the rapporteur on items 6 (b), (c), (d) and (e)

Date	*Item*	*Description*
10.30 a.m.-1 p.m.	6 (f)	The proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance
3-4.30 p.m.	6 (g)	Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries
4.30-6 p.m.	6 (h)	How treaties are developed: practical issues
Thursday, 22 October 2009		
10-10.30 a.m.		Report of the rapporteur on items 6 (f), (g) and (h)
10.30 a.m.-12 noon	6 (i)	Dispute resolution
12 noon-1 p.m.	6 (j)	General issues in the review of commentaries of the United Nations Model Double Taxation Convention between Developed and Developing Countries
3-5 p.m.	6 (k)	Transfer pricing, including a manual and checklist for developing countries
Friday, 23 October 2009		
10-10.30 a.m.		Report of the rapporteur on items 6 (i), (j) and (k)
10.30-11 a.m.	7	Dates and agenda for the sixth session of the Committee
11 a.m.-1 p.m.	8	Adoption of the report of the Committee on its fifth session
3-5.30 p.m.	8	(*continued*)
5.30-6 p.m.		Closing of the fifth session

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Committee of Experts on International Cooperation in Tax Matters
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Recent work of the Organization for Economic Cooperation and Development on the attribution of profits to permanent establishments: implications for the United Nations Model Double Taxation Convention between Developed and Developing Countries

Note by the Secretariat*

Summary

At its fourth session in 2008, the Committee of Experts on International Cooperation in Tax Matters, in considering the agenda for its fifth session, accepted an offer by a member of the Committee, Robin Oliver, to prepare a paper addressing some of the issues that might be relevant for the Committee's consideration of issues related to the attribution of profits under article 7 of the United Nations Model Double Taxation Convention between Developed and Developing Countries.

The paper circulated under cover of the present note addresses recent developments at the Organization for Economic Cooperation and Development in the area of attribution of profits, and considers their possible relevance for the United Nations Model Double Tax Convention between Developed and Developing Countries and the work of the Committee.

* The views and opinions expressed in the present note are those of the author and do not necessarily represent the views and opinions of the Committee of Experts on International Cooperation in Tax Matters, the United Nations or any other organization.

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I. Introduction

1. At its fourth session in 2008, the Committee of Experts on International Cooperation in Tax Matters, in considering the agenda for its fifth session, accepted the offer of a member of the Committee, Robin Oliver, to prepare a paper on some of the issues that might be relevant for the Committee's consideration of issues related to attribution of profits under article 7 of the United Nations Model Double Taxation Convention between Developed and Developing Countries (see E/2008/45, para. 45). That paper, submitted in the present note, addresses developments at the Organization for Economic Cooperation and Development (OECD) in the area of attribution of profits, and considers their possible relevance for the United Nations Model Double Tax Convention between Developed and Developing Countries and the work of the Committee.

2. Efforts to achieve international consensus on how to attribute profits to a permanent establishment, and therefore on determining the extent to which profits are taxable in the State in which a permanent establishment is located, started more than 80 years ago in the League of Nations.

3. The current OECD efforts, which started in 1998, constitute the most recent attempt at reducing the potential for double taxation that can arise if the home State and the host State do not agree on the same attribution of profits to a permanent establishment.

4. While there are differences between the OECD and the United Nations versions of article 7, the basic principle underlying the determination of a permanent establishment's profits is the same: one should attribute to the permanent establishment the profits which it might be expected to make if it were a distinct enterprise dealing at arm's length with the rest of the enterprise.

5. Probably the most important conceptual difficulty raised by the application of this principle relates to transfers occurring between the permanent establishment and other parts of the enterprise. To take a simple example, assume that a company resident of State R manufactures tables in State R and sells them in a store located in State S. The store is a permanent establishment of the company. Clearly, the sales are taxable in State S but it is also clear that the profits from these sales are less than the sale price. Expenses incurred outside State S must therefore be allowed in determining the profits of the permanent establishment but if the expenses incurred in State R for the purposes of manufacturing these tables are simply deducted from the sale price of the tables, all of the company's profits from the sales will be taxable in State S and none will be taxable in State R, even though this is where the tables were manufactured. In other words, no part of the profits would be attributed to the manufacturing function, a result that is clearly wrong.

6. Over the years, countries have developed different approaches for determining how profits should be attributed to a permanent establishment. The main differences between these approaches probably relate to the recognition of profits from internal transfers, to and from a permanent establishment, of capital, services, intangibles and property.

7. Historically, the extent to which the legal fiction of the "separate arm's length enterprise" provision of article 7 requires or allows these various approaches has been far from clear. What has been clear, however, is that double taxation of the

same profits can result from their application. This is why OECD started work on these issues. This work is noted below as being instructive for the work of the Committee of Experts on International Cooperation in Tax Matters in this area and as representing an approach that Member States will come across during negotiations, but not, of course, as a suggestion that the Committee's work and the United Nations Model need to be driven by the OECD work and Model.

8. OECD is currently in the process of fundamentally changing article 7 (Business profits) and its related commentary in the Model Tax Convention.

9. The revised article 7 will implement the conclusions of the report on the attribution of profits to permanent establishments, which was approved by the OECD[1] Committee on Fiscal Affairs on 24 June 2008 and represents the outcome of 10 years of work on how the "separate arm's length enterprise" provision of article 7 should be applied.

10. Because the conclusions of the OECD report reflect views on how the article ought to be applied and not on how it has been applied on the basis of the current version of article 7, the conclusions of the report are being implemented in the OECD Model Tax Convention in two stages.

11. The first stage is the revision of the existing commentary to article 7. This stage, which was completed in the 2008 updating of the OECD Model,[2] is aimed at implementing the conclusions of the report that do not conflict with the interpretation already provided in the commentary.

12. The second stage is the finalization of a completely new article 7 with related commentary changes for adoption in the next updating of the OECD Model in 2010. A draft discussion paper on a revised article 7 and related commentary was released by OECD for public consultation in July 2008.[3]

II. Article 7 of the Model Tax Convention

13. At present, article 7 of the OECD Model Tax Convention allocates taxing rights between contracting States in relation to business profits. The State in which the enterprise is resident ("residence State") is entitled to tax business profits of the enterprise earned in the state of source ("source State"). The source State is also allowed to the tax business profits of the enterprise but only if the profits are attributable to a permanent establishment in the source State (the existence of a permanent establishment is determined under article 5 of the OECD Model). The residence State is then required to give a credit or exemption for any source State taxation against the tax that the residence State imposes on the enterprise.

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[1] OECD Centre for Tax Policy and Administration, "Report on the attribution of profits to permanent establishments, 17 July 2008. Available at http://www.oecd.org/dataoecd/20/36/4103155.pdf.

[2] Ibid., "The 2008 update to the OECD Model Tax Convention, 18 July 2008". Available at http://www.oecd.org/dataoecd/20/34/41032078.pdf.

[3] Ibid., "Discussion draft on a new article 7 (Business profits) of the OECD Model Tax Convention, 7 July to 31 December 2008". Available at http://www.oecd.org/dataoecd/37/8/40974117.pdf.

14. Since the source State is only allowed to tax profits attributable to a permanent establishment, it is important to know how those profits are calculated. Paragraph 2 of article 7 sets out an arm's length rule for determining the amount of profits attributable to a permanent establishment. The profits to be attributed under paragraph 2 by both the residence State and the source State are considered to be:

> "... profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."

15. The general approach to profit attribution under the present article 7 is to start with the branch accounts and to make adjustments as necessary to ensure an overall arm's length amount of profit is taxed in the permanent establishment.

16. Actual expenses or costs incurred by the enterprise on behalf of the permanent establishment in deriving the gross income of the permanent establishment are deductible, whether incurred directly for the purposes of the permanent establishment (e.g. the salary of a person who works exclusively at the permanent establishment for the benefit of that permanent establishment) or indirectly for the benefit of the permanent establishment (e.g. head office expenses). No head office markup of costs is permitted, except in certain cases.

17. Furthermore, except in limited cases (such as loans between branches of a bank) the present article 7 and commentary do not recognize internal dealings between the permanent establishment and head office or the permanent establishment and another part of the enterprise which would give rise to notional dividends, royalties or interest from the permanent establishment to that other part of the enterprise, or vice versa.

III. Report on the attribution of profits to permanent establishments

18. The 2008 OECD report is comprised of four parts. Part I, General considerations, sets out the general framework for the new approach to attribution of profits. Parts II to IV of the report focus on banking, global trading and insurance, respectively.

19. The central aim of part I of the report is to take the concept of treating the permanent establishment as a separate entity a good deal further than does the present article 7. The idea is to achieve a greater level of consistency between the taxation of branches and the taxation of subsidiaries under treaties.

20. Under this approach, the attribution of profits to a permanent establishment will be calculated to reflect all of the activities of the permanent establishment, including transactions with independent enterprises and associated enterprises and its dealings with other parts of the enterprise.

21. Part I of the report establishes a two-step process for the attribution of profits to a permanent establishment. The first step is to hypothesize the permanent establishment as a separate legal entity using functional and factual analysis. As explained in paragraph 19 of the above-mentioned draft discussion paper, this analysis will determine:

(a) The attribution to the permanent establishment, as appropriate, of the rights and obligations arising out of transactions between the enterprise of which the permanent establishment is a part and separate enterprises;

(b) The identification of significant people functions relevant to the attribution of economic ownership of assets, and the attribution of economic ownership of assets to the permanent establishment;

(c) The identification of significant people functions relevant to the assumption of risks, and the attribution of risks to the permanent establishment;

(d) The identification of other functions of the permanent establishment;

(e) The recognition and determination of the nature of those dealings between the permanent establishment and other parts of the same enterprise that can appropriately be recognized, having passed the threshold test referred to in paragraph 23 [of the new draft Commentary];

(f) The attribution of capital based on the assets and risks attributed to the permanent establishment.

22. A core feature of this approach is a determination of whether the permanent establishment has significant people functions. Assets, risks and capital are allocated to the permanent establishment in a balance sheet approach to support those functions. The OECD report gives examples of significant people functions. For instance, in the case of internally created intangibles, paragraph 116 of part I states that:

> "The significant people functions relevant to the determination of the economic ownership of internally created intangibles are those which require active decision-making with regard to the taking on and management of individual risk and portfolios of risk associated with the development of intangible property."

23. The second step of the authorized OECD approach is to determine the profits attributable to the permanent establishment in relation to its transactions and dealings. The 1995 transfer pricing guidelines[4] are relevant for pricing transactions between the permanent establishment and associated enterprises. The guidelines are also to be applied, by analogy, to price the dealings between the permanent establishment and other parts of the enterprise.

24. Accordingly, unlike the present article 7, this approach would recognize dealings in the nature of, say, a license provided by a head office (the economic owner of the intellectual property) to a permanent establishment that is using the intellectual property. The notional license would, in turn, give rise to a notional royalty from the permanent establishment to the head office through a reduction of the profits of the permanent establishment by the amount of that notional royalty.

25. The 2008 draft discussion paper of OECD makes it clear that the separate and independent enterprise fiction (including the recognition of notional dealings and notional payments) is confined to determining the attribution of profits to a permanent establishment under article 7. In other words, in the above-mentioned

[4] Approved by the OECD Council on 27 June 1995 and published in loose-leaf form as "Transfer pricing guidelines for multilateral enterprises and tax administrations" (OECD, Paris, 1995).

example of notional royalty, the notional royalty is not to be treated as an actual royalty for the purposes of article 12 of the Model Tax Convention because there is no actual payment of a royalty for the purposes of that article. Consequently, there will be no allocation of source State withholding tax rights in respect of that notional royalty. If a jurisdiction wanted to reserve the right to tax a notional royalty or other notional payment, it would need to negotiate a special provision for inclusion in its bilateral treaty. Even then, it would need to be able to impose taxation under domestic law to give practical effect to that provision.

26. The OECD report contains a special rule for tangible property, such as equipment and immovable (real) property. In general, economic ownership of tangible assets is allocated to that part of the enterprise in which it is being used. This means that recognition of notional dealings relating to the tangible property actually used by the permanent establishment is not expected to occur very often. It should be recognized, however, that this is a general rule and that, in the proper circumstances, it might be possible to argue that tangible property, including immovable property, used by a permanent establishment has been transferred to it under a dealing giving rise to notional rental payments for the sole purposes of article 7. As is the case with royalties (see above), such payments would not be treated as an actual rent for the purposes of articles 6 and 12 of the OECD Model.

27. A number of other important issues relating to the taxation of permanent establishments arise from the OECD report. A discussion of these issues is, however, beyond the scope of the present paper.

IV. Implementation of the conclusions of the OECD report and the implications for bilateral treaties

First stage: partial implementation through revision of the commentary to article 7

28. The 2008 update to the OECD Model Tax Convention contains a revised commentary to article 7. The revised commentary is only a partial implementation of the conclusions of the OECD report: the conclusions contained in parts I to IV of the report are implemented, but only to the extent that the report does not conflict with the present commentary to article 7. This limited implementation was necessary because the conclusions contained in part I of the report constituted a reversal of the interpretation of article 7 in the present commentary.

29. In particular, the previous version of the commentary specifically provided that, subject to specific exceptions, internal dealings would not be recognized and no deduction could be made for notional payments of interest and royalties. This position is maintained in paragraph 34 of the revised commentary to article 7. Accordingly, the recognition of notional dealings and the deduction of such notional payments in the attribution of profits does not apply in relation to the present article 7.

30. The result is that much of the interpretation in the revised commentary preserves the status quo in relation to the interpretation of the present article 7 of the OECD Model and is not affected by the conclusions of the 2008 report.

31. Bilateral treaties which are based on the OECD Model and contain the former article 7 will normally be interpreted in line with the 2008 update to the OECD Model. In general terms, this means that dealings will not be recognized in determining the profits attributable to a permanent establishment.

Second stage: new article 7 and new commentary in 2010

32. The conclusions of the OECD report will be fully implemented in the OECD Model when the revised article 7 and commentary are adopted by the Committee on Fiscal Affairs. As mentioned above, a draft text of the revised article 7 and commentary was released for public consultation in July 2008. Submissions on the draft text have been received and the adoption of the revised article and commentary is scheduled for 2010, when the OECD Model will next be updated.

33. Bilateral treaties which adopt the wording of the revised article 7 will be interpreted in line with the revised commentary to the article.

V. Implications for Member States of the United Nations

34. Paragraph 3 of article 7 of the United Nations Model Double Taxation Convention between Developed and Developing Countries is more explicit than the OECD Model in disallowing deductions for notional payments, except in the case of notional interest on intrabank lending. The author has always interpreted this as making explicit that which in the OECD Model is more implicit.

35. The revised commentary to article 7 of the OECD Model therefore may have implications for countries using the United Nations Model. Because of the limited nature of the change made to the commentary in the 2008 update, this should have no substantial impact. New Zealand has noted in its observations on article 7 that it does not agree with the approach put forward on the attribution of profits to permanent establishments in general, as reflected in part I of the report on the attribution of profits to permanent establishments.

36. This observation to the commentary reflects the concerns of New Zealand with regard to the 2008 OECD report more generally and the effect that its conclusions could have on the balance between residence and source taxing rights. In particular deductions for dealings and thus notional payments between a permanent establishment and its head office could reduce source taxation. Nevertheless, this only becomes an issue of significance if countries enter double taxation agreements based on a revised article 7 of the OECD Model and is not a result of updating the commentary.

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Item 6 (h) of the provisional agenda*
How treaties are developed: practical issues

Tax treaty process for developing countries

Note by Mr. Victor Thuronyi**

Summary

At its fourth session, in 2008, the Committee of Experts on International Cooperation in Tax Matters, in considering the agenda for its fifth session, accepted an offer by Victor Thuronyi to prepare the present background paper. The paper addresses some of the issues that may be relevant for the Committee's consideration of the agenda item "How treaties are developed: practical issues".

* E/C.18/2009/1.

** Senior Counsel (Taxation), International Monetary Fund. The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board or its management. The author is grateful to Patricia Brown, Michael Keen, Lee Burns, Peter Harris, Geerten Michielse and Michael Lennard for their helpful comments and to Sebastien Drevet for his assistance in preparing this document.

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I. Introduction: tax treaty process and a subgroup

1. At its fourth session, in 2008, the Committee of Experts on International Cooperation in Tax Matters, in considering the agenda for its fifth session, accepted an offer by Victor Thuronyi to prepare the present background paper.[1] The paper addresses some of the issues that may be relevant for the Committee's consideration of the agenda item "How treaties are developed: practical issues".

2. The paper explores the process for concluding tax treaties[2] involving developing countries. This process issue is closely connected to the United Nations Model Double Taxation Convention between Developed and Developing Countries, which is intended to provide guidelines for developing countries in negotiating their treaties. The text of the Model and of the Commentary thereon include draft treaty language. The tax treaty process deals with how that language is or might be used in treaty negotiations. This paper looks at various aspects of the treaty process. One idea arising from it is that it would be useful for the Committee of Experts to form a permanent subgroup to further examine some of these issues. The discussion in the paper is therefore intended to be preliminary, the objective not necessarily being to reach conclusions but rather to raise questions and outline some of the issues that such a subgroup might address. In general, the subgroup could address any aspects of the tax treaty process that go beyond the formulation of specific language for the articles of the Model and the Commentary.

II. Use of the United Nations Model

3. Of relevance to the United Nations Model is the extent to which its provisions are used in treaties being negotiated today or recently negotiated. For this purpose, it would be instructive to examine treaties negotiated relatively recently to determine how widely particular provisions of the United Nations Model are used, and in what contexts.[3] Such an analysis may suggest priorities for future Committee focus, and may lead to removing provisions that are not used, better explaining the impact of particular provisions, and analysing why they may or may not be chosen as options, particularly as compared with other options to achieve similar policy outcomes.

4. Also of interest is whether treaties concluded by developing countries have included provisions that are found neither in the United Nations Model nor in the OECD Model. If they are, the Committee may want to discuss such provisions to ascertain whether guidance should be provided by:

(a) Including alternatives in the Model or the Commentary that are seen as providing an effective response to the needs of particular relationships and negotiations;

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[1] See report on the fourth session, E/2008/45, para. 82.

[2] While many types of treaties relate to taxation, for the sake of simplicity, this paper uses the term "tax treaty" or "treaty" to refer to a full double tax treaty similar to the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital or the United Nations Model Tax Treaties, unless the context otherwise requires.

[3] This has already been suggested by the Committee of Experts at its fourth annual session. See E/2008/45-E/C.18/2008/6, para. 71.

(b) Pointing out some of the difficulties that specific alternatives found in actual treaty-making practice may create, especially for developing countries; or

(c) Concluding that some alternative approaches that respond to the individual needs of specific countries are not necessarily of broader interest and therefore do not need to be referred to in the United Nations Model or Commentary.

5. An initial step might be to prepare a background report summarizing the experience with treaties, differentiating those signed in recent years from older ones that remain in force. In this respect, it is worth bearing in mind that the United Nations Model should continue to play a guidance role in respect of treaties that do not reflect more recent negotiation policy and practice, but remain in force and must be administered.

III. Negotiation guidance

6. One of the functions of the United Nations Model is to provide a framework for treaty negotiation between developed and developing countries; in other words, to provide guidance on treaty negotiation. The Model does so largely by providing suggested language for the treaty, but perhaps more can be done explicitly by providing guidance for negotiators, beyond the provision of specific treaty language.

7. In this respect, an interesting aspect of negotiating policy is the extent to which developed countries should try to gain a negotiating advantage.[4] It is quite likely that OECD countries often do make efforts to protect the interests of their developing country treaty partners and do not try to take full advantage of their position. It would be interesting to learn whether this attitude of restraint is in fact significant in negotiations and, if so, whether it could be brought more to the forefront; specifically, whether guidelines could be formulated on the extent to which OECD countries should concede source taxation to non-OECD countries. For example, can we see evidence in particular treaties where some OECD countries are negotiating provisions that allow their companies to escape source country taxation (perhaps escaping taxation altogether) in specific cases?[5] In other words, to what extent are treaties between OECD countries and developing countries being used as instruments to enhance the competitive position of companies headquartered in the negotiating OECD country by giving them the opportunity to achieve double non-taxation? Is this appropriate and, if not, what can be done to minimize the occurrence of such cases?

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[4] See generally Kim Brooks, "Tax treaty treatment of royalty payments from low-income countries: a comparison of Canada and Australia's policies", *eJournal of Tax Research*, vol. 5, No. 2 (2007), pp. 168-197. In many cases, the OECD country partner may have a general foreign policy interest in supporting the development of a robust revenue-raising system of the non-OECD member. The OECD country may also be providing direct budgetary support to the other country. From the perspective of the whole relationship between the countries, it is therefore often the case that the OECD country has an interest in strengthening, rather than undermining, the revenue-raising potential of the other country's tax system. In this context, it may be counterproductive to negotiate a treaty that does the latter (an extreme example might be a treaty with no limitation on benefits provisions and a zero withholding rate on interest income.

[5] See, for example, Rick Krever's discussion of the Canada-Mongolia treaty in Arthur J. Cockfield (ed.), University of Toronto Press, "Globalization and the impact of tax on international investments" (forthcoming).

8. Another area where guidance may be helpful for developing countries is the extent to which the United Nations Model is relevant for treaties between one developing country and another. A negotiation between two developing countries may differ from a negotiation between a developed and a developing country because flows of capital and trade "... may be much more balanced between two developing countries". This suggests that a developing country may be much less interested in insisting on source-based jurisdiction than when it negotiates with a developed country. The contrary argument, however, is that there may be a strategic reason for developing countries to adopt a uniform policy, regardless of the negotiating partner, so as to minimize treaty shopping and avoid setting a precedent for future negotiations with other countries. In other words, in negotiating a specific treaty, a country needs to be aware of potential implications for its treaty network as a whole. These are some of the issues on which a subgroup could develop guidance for developing country treaty negotiators that could help developing countries formulate a treaty negotiating strategy.

9. Another aspect of treaty strategy on which guidance could be provided is the renegotiation of existing treaties. What criteria should be used in deciding whether an existing treaty should be renegotiated (or even terminated)?

IV. Enhancing negotiation capacity

10. In formulating guidance to developing countries, it may be useful to look at a number of issues. How many developing countries have negotiating teams that are fully capable of negotiating treaties? What should countries without such teams do when they face the prospect of negotiating a treaty? Would it make sense for them to routinely use outside advisers with the requisite negotiating experience and expertise? How often do countries do this? Can the Committee of Experts provide advice or guidelines on this point?

V. Assessing administrative capacity

11. How many developing countries are in a position to properly administer tax treaties? If they lack such capacity, what are the implications for the extent to which it is desirable for them to enter into treaties? If this capacity is lacking or needs improvement, what — if anything — should be done?

VI. Developing a treaty strategy

12. The number of treaties differs significantly between developed and developing countries.[6] The Member States of the United Nations can be divided into three major groups in this respect. Group I, consisting of 66 countries, is composed of the OECD countries plus others that have at least 34[7] treaties. On average, Group I countries have 59 treaties each and Group II countries (those with 10-33 treaties)

[6] See Drevet and Thuronyi, "The tax treaty network of the U.N. Member States", *Tax Notes International*, p. 783 (June 1, 2009). The statistics in this paragraph are based on the situation as at the end of 2008. The numbers should be treated as estimates only.

[7] The number of treaties of the OECD member with the fewest of treaties (New Zealand).

19 treaties each. Finally, Group III countries, 89 of which have fewer than 10 treaties, average only 3 treaties each (an average that is lowered by some 30 countries with no treaties at all).[8]

13. While many developing countries are actively engaged in treaty negotiations and have extensive treaty networks, this is obviously not the case for many others. Even most countries in Group II have a fairly low number of treaties and the developing countries in Group III have none or very few. Thus, the typical developing country has relatively few treaties. Is this appropriate? How many treaties does a country need, and with which partners?

14. The proposed subgroup could address these questions and, more generally, provide guidance for developing countries in determining their treaty strategy. This guidance could include a discussion of the considerations that developing countries could take into account in formulating a strategy for tax treaty negotiation. In other words, how can developing countries strategically use their scarce negotiating resources? To some extent, technical personnel in developing countries may already know the answer to this question, but having the considerations spelled out explicitly by a multilateral body may give them justification to, for example, resist calls from their Ministry of Foreign Affairs to negotiate a treaty with country X when, from a tax policy standpoint, such a treaty would not be needed.

15. Presumably, most countries could benefit from additional treaties.[9] However, treaties are not free goods, since their negotiation and administration involves opportunity costs in terms of human resources and expenses. The fact that many countries are not actively engaged in negotiating and signing treaties could mean that they have higher priorities, lack sufficient negotiating capacity or face other obstacles to the negotiation process.

16. One obstacle could be that a potential treaty partner's negotiation team may be busy negotiating or renegotiating other treaties. A potential partner may also be unwilling to negotiate a treaty that does not follow their preferred model, which may be unacceptable to the country in question.

17. Also relevant are the length of the negotiation period, the expense of establishing a treaty network in terms of time, skills and money, and the limited capacity of countries for treaty negotiation. This is the case even for large countries. For example, in recent years, Canada has been entering into treaty negotiations with

[8] Alternatively, a Group IV could cover the countries with no treaties, in which case Group III would consist of 53 countries with an average of about 4 treaties each.

[9] The attitude of the Committee of Experts seems to be that it would be desirable to have more treaties; for example, paragraph 46 to the Commentary to the United Nations Model (2001) states: "It is hoped that the United Nations Model Convention will contribute to the conclusion of an increasing number of bilateral tax treaties, not only between developed and developing countries but also between developing countries." The benefits and effects of treaties are, however, by no means clear. See Ronald Davies, "Tax treaties and foreign direct investment: potential versus performance", *International Tax and Public Finance*, vol. 11, No. 6 (2004), pp. 775-802; Tsilly Dagan, "The tax treaties myth, 32 N.Y.U. J", *Journal of International Law and Politics*, vol. 32, No. 939 (2000) (arguing that treaties are not needed to eliminate double taxation and may not be advantageous on balance for developing countries). Eric Neumayer, "Do double taxation treaties increase foreign direct investment to developing countries?", *Journal of Development Studies*, vol. 43, No. 8 (2007), pp. 1501-1519, provides a positive answer to the question, but only for higher-income developing countries.

about three countries per year.[10] The United States Treasury Department has stated: "The primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. Ensuring that the various functions to be performed by tax treaties are all properly taken into account makes the negotiation process exacting and time consuming" (statement of Michael Mundaca, 10 July 2008). In recent years, the United States has signed less than half a dozen treaties a year, most of which are amendments of existing treaties[11] (see United States Treasury Department website) and concluded with OECD countries.

18. It is fairly clear that the pace of treaty negotiation is so slow that it would take several decades for many OECD countries to expand their treaty network to include even most non-OECD countries. Therefore, even if countries were to decide that it would be a good idea to substantially expand the existing treaty network, it would not be feasible over the short term.

19. Each country should develop a treaty strategy in the light of the above factors. In deciding whether to enter into negotiations on a particular treaty with a particular partner, a country may appropriately ask:

(a) What problems, if any, exist in relation to this country that need to be resolved by a treaty? Is there an alternative way of resolving these problems?

(b) Is the level of trade, investment or other relevant transactions between the two countries concerned high enough that the problems are substantial?

(c) Will the costs of negotiating a treaty to resolve the problems be justified? Are there other more pressing priorities? Are there obstacles relating to the potential treaty partner suggesting that a treaty may not be successfully concluded?

20. A subgroup could appropriately flesh out these considerations to help developing countries formulate a strategy for strategically using their limited negotiating skills.

21. In addition, the issue of negotiating new treaties can be viewed at a more global level. In this context, one could reasonably assume the following:

(a) Most developing countries (many of the countries in Group II and most in Group III) lack the capacity to negotiate a substantial number of treaties;

(b) On the whole, the capacity of many developing countries to administer treaties is weak. Their tax administrations are typically challenged in terms of human resources, to the extent that even if they had staff who could properly negotiate and administer treaties, such activities would be unlikely to constitute the best use of staff time;

(c) It would take a lifetime for most developing countries to negotiate a substantial number of treaties;

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[10] See the website of Department of Finance Canada at http://www.fin.gc.ca/treaties-conventions/treatystatus_-eng.asp.

[11] In a 2007 report, the United States Treasury Department explains that a continual process of amendment of existing treaties is needed to protect against abuse of the existing treaty network, in response to the "evolutionary nature of tax planning". See United States Treasury Department *Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties*, p. 87 (2007).

(d) Applying the criteria above, most developing countries probably do not have a compelling need for a full-fledged treaty with most other countries.

22. An implication of the above is that it makes little sense to envisage substantially expanding the treaty networks of most developing countries. If this premise is accepted, the question arises of whether other measures exist to fulfil the goals of treaties: the elimination of double taxation and the prevention of tax evasion.

VII. Unilateral measures

23. Double taxation can be largely eliminated on a unilateral basis in each country's domestic law. In fact, most countries have already adopted unilateral measures to this effect, although some fine-tuning is likely needed. A subgroup could usefully develop guidance on this point.

24. Thus, each country could either grant a foreign tax credit (with appropriate limitations) or exclude some or all foreign-source income from tax (virtually all developing countries already have such unilateral rules: very few tax foreign-source income without granting a foreign tax credit).

25. In terms of taxing non-residents, each country could provide that a non-resident is taxed on income from doing business in the country only if the non-resident has a permanent establishment in the country (virtually all countries already have such rules). The main issue here would be the definition of permanent establishment. Guidelines and options (including references to country examples actually in use) could be provided for this purpose (this would largely involve translating the provisions of the United Nations Model into domestic law, and so should not be too difficult to develop).

26. Typically, countries tax non-residents on income from immovable property located in the jurisdiction, and in this case, no special provisions would be needed because treaties generally allocate jurisdiction to tax in the source country.

27. For dividends, interest and royalties, the main role of treaties is to limit the rate of withholding. Countries can achieve the same result unilaterally by exercising moderation in setting the rate of withholding tax, which they may find an appealing option for attracting international capital. This may suggest the need for a coordinated approach to setting limits with which developing countries could feel comfortable. Any such internationally coordinated limit would presumably be solely a recommendation and not binding. In practical terms, a coordinated limit may serve as a floor more than as a ceiling. In other words, the existence of a coordinated tax rate may encourage countries to tax up to this amount. There would be no need to define interest, dividends or royalties for the purposes of such a limitation, since the definition would be provided in domestic law.

28. For capital gains, unilateral provisions taxing non-residents on capital gains could follow the United Nations Model. This would allow for the taxation of gains from the disposition of: property that is part of a local business; interests in immovable property located in the jurisdiction; indirect interests in such property (such as through real property holding companies); and shares in resident companies. Other capital gains of non-residents would not be taxed. Again, the

details of how these gains would be defined (for example, the definition of indirect interests) would be part of local law, not part of a treaty.

29. Concerning employment income, a unilateral measure similar to article 15, paragraph 2, of the United Nations Model could be taken exempting the income of an employee who is present in the jurisdiction for less than half of the year, where the remuneration is paid by a non-resident (and is not being deducted by a resident). Similarly, a unilateral exemption for payments for government service similar to article 19 of the United Nations Model could be included in local law.

30. Some countries assert their source jurisdiction fairly strongly, with the view that treaties will cover their important trading partners and that the resulting withholding taxes will fall largely on payments to countries that are not treaty partners. This approach may work particularly well for countries having an extensive treaty network. Countries wishing to take this kind of approach could do so even without a treaty network, by identifying in their domestic law the countries to which certain provisions would apply. For example, it is quite common to apply controlled foreign corporation rules to subsidiaries located in low-tax jurisdictions. In other words, countries can compile lists or groups of countries unilaterally, without relying on the proxy of a country's treaty status.

31. Guidance could also be provided for the appropriate formulation of source rules, so as to avoid source-source jurisdictional overlaps. For example, if a country wishes to impose a withholding tax on interest paid abroad, what should be the scope of application (a typical answer may be to impose the withholding tax on interest that is deductible as a business expense in the source country)?

32. Another topic for the envisaged subgroup could be to provide guidance for the unilateral exercise of taxing jurisdiction by developing countries. Such guidance need not take the form of recommended positions; rather, the subgroup could serve as a forum for the technical discussion of issues and reviews of country practice, so that each country would have sufficient information to independently determine how to proceed.

VIII. A "light" treaty

33. Some issues cannot be addressed on a unilateral basis. It may be instructive for the subgroup to consider the utility of a more limited treaty that could be signed by many countries. Theoretically, a light treaty would have to be designed in such a way as to avoid having to delve into the details of each country's tax system.

34. Ideally, a light treaty would be multilateral (and universal — a set of regional multilateral treaties would be of some use but not as good as a single treaty including most countries or, albeit less desirably, a set of bilateral treaties). Given that it would be a general treaty and, as such, its purpose would not be to coordinate all aspects of the tax systems of the treaty partners, there would be no particular advantage to structuring it as a set of bilateral treaties. In practice, however, only a few multilateral treaties have been concluded in the tax area and most tax treaties are bilateral. If, for any reason, it were considered too difficult a diplomatic matter to negotiate a multilateral treaty with many treaty partners, then a series of bilateral treaties would be a fallback solution that would be technically feasible. It would also be possible for a number of bilateral treaties to coexist with one or more

multilateral treaties with a limited number of partners, similar to some regional multilateral tax treaties today.

35. One risk of negotiating a light treaty in a bilateral format is that the negotiators could become distracted by the various issues that they may be tempted to include in the treaty, beyond the standard bare-bones provisions. Negotiations could also be prolonged by the temptation to adjust treaty language. In both cases, substantial complexity would arise from differences in treaty terms: each time a treaty was applied, its particular language would have to be studied. The use of a bilateral format would require a level of restraint that may be unrealistic to expect. In the absence of such restraint, negotiations could go off-track or take an undue amount of time.

36. A multilateral treaty would minimize this risk (although countries could still include bilateral protocols). A multilateral treaty could also be signed by a smaller group or by groups of countries, for example on a regional basis.

37. A light multilateral treaty might address only a few issues, such as:

(a) Exchange of information;

(b) Administrative cooperation in tax collection (enforcement of tax judgements in another country's courts);

(c) Non-discrimination (article 24 of the United Nations Model);

(d) Residence tie-breaker rule;

(e) A mutual agreement procedure.

38. In a multilateral treaty, the first three elements could be similar to the relevant contents of the current OECD or United Nations Models (or of tax information exchange agreements, or TIEAs[12]), and so do not need extensive discussion here. The tie-breaker rule and mutual agreement procedure would be somewhat different from the current provisions in the Model for bilateral treaties.

39. In a multilateral treaty, a tie-breaker rule could be designed in such a way as to exclude dual residence for tax purposes, at least in respect of those countries that are willing to do so among themselves. Such a provision would be particularly useful in triangular cases. However, if not all countries agreed to apply the tie-breaker rule to all the other countries that are parties to the multilateral treaty, some cases (perhaps mostly theoretical) of dual residence could occur. For example, if country A agreed to eliminate dual residence with a group of countries that includes country C, and country B agreed to eliminate dual residence with a group of countries that includes country C (but not country A), there could still be a case where someone was a dual resident of countries A and B (although in practice this would likely be extremely rare). This could arise where an individual is considered a resident under the domestic laws of A, B and C. Under a multilateral treaty, if applying the treaty between A and C, residence might be assigned to country A, and if applying it between B and C, residence might be assigned to country B, with the result that both

[12] See OECD, Agreement on Exchange of Information on Tax Matters (2002) (taking the form of both a bilateral and multilateral agreement), available on the OECD website: http://www.oecd.org/dataoecd/15/43/2082215.pdf.

A and B would tax the individual as a resident.[13] While this is somewhat inelegant, it is a result of the fact that countries A and B (for any given reason) did not choose to include each other in the group of countries with which they would agree to apply the tie-breaker rule.[14] In principle, in this situation, the elimination of double taxation could still be accomplished under the mutual agreement procedure if needed.[15]

40. A residence tie-breaker rule would be effective in eliminating double taxation, as long as countries unilaterally refrain from asserting extensive jurisdiction over non-residents. For example, suppose an individual is a resident of both States A and B under their respective domestic laws, but is a resident only of State B under the tie-breaker. Suppose further that the individual does not have a permanent establishment in State B. There is nothing to prevent State B from taxing the individual on business income earned in State B, but if B unilaterally adopts the principle that a non-resident without a permanent establishment is not taxed in B, then the individual will be taxed only in State A.

41. Provisions for a mutual agreement procedure in a light treaty could be consistent with article 25, paragraph 3,[16] of the OECD and the United Nations Models. The procedure could be used not only to resolve "any difficulties or doubts" that may arise in the application of the treaty, but also to avoid double taxation "in cases not provided for" in the treaty.[17] However, the expression "in cases not provided for in the Convention" could have a broader function than it does under

[13] Assume that X, a national of A, is a resident of countries A, B and C under the domestic tax laws of these countries. X does business in these countries. Managing his businesses requires him to spend a significant period of time in each of these countries. During these periods, X, together with his wife and a young child, lives in the permanent homes they own in each of the three countries. Because his family always follows him and he has investments in each of these countries, suppose that X's centre of vital interests cannot be determined. X has a vacation home in B, which would be considered an habitual abode. Under the A-C treaty, X is a resident of A because he is a national of A. Under article 4, paragraph 3 of the United Nations Model, given that he has a permanent home in both countries, his centre of vital interests cannot be determined, and he has an habitual abode in both States or neither, he is considered a resident of the country where he is a national. Under the B-C treaty, X is a resident of B because he has an habitual abode in B. If A and B have no treaty with each other, X will be a resident of both A and B.

[14] Not all countries routinely agree to tie-breaker rules. For example, the United States Model Income Tax Convention of 15 November 2006 does not contain a tie-breaker rule for companies, and the tie-breaker rules for individuals included in United States treaties have only a limited application. See article 1, paragraph 4, technical explanation of the Model, United States Department of the Treasury.

[15] Under paragraph 8.2 of the Commentary on Article 4 of the OECD Model (as revised in 2008), the same problem would arise if there were no A-B treaty: the individual would be treated as a resident of both A and B (and not of C).

[16] Article 25 paragraph 3 of the OECD and the United Nations Model Conventions provide that "The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

[17] A number of treaties contain the second sentence of article 25, paragraph 3 of the OECD and the United Nations Model Conventions (see, for example, treaties between the United States and Japan; the United States and the United Kingdom; the United States and Germany, Austria and Germany, Canada and Denmark, and Canada and the United States).

existing treaties,[18] in which this expression typically refers to situations that are within the spirit of the treaty although not specifically covered. In contrast, in a light treaty, the expression could refer to any cases of double taxation not envisaged in the treaty. Because the light treaty would have very few substantive provisions, the number of potential cases eligible for the mutual agreement procedure would be much greater in principle. For example, in a bare-bones treaty, transfer pricing is an obvious example of where double taxation can occur. The idea of a mutual agreement procedure would be to give the competent authorities the power to address inconsistent transfer pricing determinations. No country would be forced, however, into making a concession under a mutual agreement procedure against its will (a light treaty presumably would not include an arbitration provision).

42. Because the light treaty being suggested would contain exchange-of-information provisions, it could substitute the need for TIEAs. That is, if two countries agreed to the light treaty, then they would not need to negotiate a TIEA between themselves. Negotiation of a multilateral treaty with exchange-of-information provisions might be a much better course of action than bilateral TIEAs, in part because of the time that would be required to establish a treaty network for TIEAs. Currently, there are few TIEAs in force. While the TIEAs signed since 2002 generally follow the structure of the OECD Model Agreement on Exchange of Information on Tax Matters, the language varies from one to another. The development of an extensive network of bilateral TIEAs would consume a great deal of negotiation time and use up resources that could be allocated elsewhere. It would also result in a complex series of agreements with slight differences in wording, thereby raising questions of interpretation and complicating the application of these agreements. It would seem far more preferable to negotiate a single universal agreement with a standard form and a single meaning.

43. Developing countries would want to see the benefits of a light treaty before entering into one. As discussed above, most double taxation issues can be addressed unilaterally, so the function of a light treaty would be limited. Such a treaty could provide a legal basis for the avoidance of double taxation by including a residence tie-breaker and a mutual agreement procedure. In addition, the treaty could provide a framework for developing countries receiving assistance from developed countries by facilitating (a) the exchange of information; and (b) the enforcement of tax claims. Developed countries could be of substantial assistance in these areas. Wealthy individuals and corporations from developing countries often have bank accounts and other assets in developed countries, and in many cases are likely not disclosing all information about these holdings to their own Governments. If the practical problems of information exchange can be solved, developed countries are in a position to provide useful information to developing countries. Similarly, if a developing country is seeking to collect tax from someone with assets located abroad, it will seek assistance from the jurisdiction where the assets are located.

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[18] See, for example, the United States-Japan treaty: in its technical explanations of article 25 of the United States-Japan treaty, the United States Treasury Department states that the provision "They may also consult together for the elimination of double taxation in cases not provided for in the Convention" "permits the competent authorities to deal with cases that are within the spirit of the provisions but that are not specifically covered." See also the technical explanation issued by the United States Treasury Department on article 26 of the United States-United Kingdom treaty.

44. Developing countries may be concerned that an exchange of information agreement would impose burdensome requirements on their tax administrations. One solution to this would be to put in place provisions for reimbursing the costs of responding to an information request. In addition, the extent of the administrative burden could be reduced if information were provided automatically by financial institutions (analogously, information concerning account holders and payments made to them is reported using a standard format under the European Union Savings Directive). Automatic provision of information could substantially benefit developing countries, since it would provide them with information even in the absence of an investigation.

45. Procedures must be developed to make both information exchange and collection assistance work for developing countries. For that purpose, however, a legal framework first needs to be established, and a light multilateral treaty can provide that framework.

46. The conclusion of a light multilateral treaty would allow developing country treaty negotiators to focus their negotiation efforts on what is perhaps a small handful of other countries with which a full-fledged bilateral treaty is considered important. A light treaty would not be intended to supplant a full treaty between, for example, neighbouring countries with heavy cross-border trade, or other important trading partners.

IX. Conclusion

47. As the discussion in this note suggests, there is an extensive potential agenda for a subgroup on the tax treaty process.

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Economic and Social Council

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Committee of Experts on International Cooperation in Tax Matters
Fifth session
Geneva, 19-23 October 2009
Agenda item 1*
Opening of the session by the representative of the Secretary-General

Outcomes of recent conferences relevant to the Committee of Experts

Note by the Secretariat

Summary

Two major recent conferences, the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha from 29 November to 2 December 2008, and the Conference on the World Financial and Economic Crisis and Its Impact on Development, held in New York from 24 to 30 June 2009, have acknowledged the role of international tax cooperation in assisting sustainable development and in addressing the global financial and economic crisis respectively. The outcome documents for both conferences referred to the need to strengthen international tax cooperation, including in relation to the Committee of Experts. The present note reproduces relevant paragraphs from the outcome documents of the two conferences, for the information of the Committee.

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I. Introduction

1. Two major conferences, the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held at Doha from 29 November to 2 December 2008, and the Conference on the World Financial and Economic Crisis and Its Impact on Development, held in New York from 24 to 30 June 2009, have acknowledged the role of international tax cooperation in assisting sustainable development and in addressing the global financial and economic crisis respectively. The outcome documents for both conferences referred to the need to strengthen international tax cooperation, including in relation to the United Nations Committee of Experts on International Cooperation in Tax Matters. Relevant paragraphs from the outcome documents of the two conferences are reproduced below for the information of the Committee.

II. Follow-up International Conference on Financing to Review the Implementation of the Monterrey Consensus

2. More than 300 hours of negotiations took place in New York prior to the Conference and during the Review Conference in Doha to finalize the Conference outcome document, the Doha Declaration on Financing for Development (General Assembly resolution 63/239, annex).

3. Paragraph 16 of the Doha Declaration states:

> "We will continue to undertake fiscal reform, including tax reform, which is key to enhancing macroeconomic policies and mobilizing domestic public resources. We will also continue to improve budgetary processes and to enhance the transparency of public financial management and the quality of expenditures. We will step up efforts to enhance tax revenues through modernized tax systems, more efficient tax collection, broadening the tax base and effectively combating tax evasion. We will undertake these efforts with an overarching view to make tax systems more pro-poor. While each country is responsible for its tax system, it is important to support national efforts in these areas by strengthening technical assistance and enhancing international cooperation and participation in addressing international tax matters, including in the area of double taxation. In this regard, we acknowledge the need to further promote international cooperation in tax matters, and request the Economic and Social Council to examine the strengthening of institutional arrangements, including the United Nations Committee of Experts on International Cooperation in Tax Matters."

4. Paragraph 20 of the Doha Declaration, while not dealing exclusively with tax evasion and avoidance, states:

> "Capital flight, where it occurs, is a major hindrance to the mobilization of domestic resources for development. We will strengthen national and multilateral efforts to address the various factors that contribute to it. It is vital to address the problem of illicit financial flows, especially money-laundering. Additional measures should be implemented to prevent the transfer abroad of stolen assets and to assist in the recovery and return of such assets, in particular to their countries of origin, consistent with the United Nations

Convention against Corruption, as well as to prevent capital flows that have criminal intent. We note the efforts of the United Nations Office on Drugs and Crime and the World Bank Group through the Stolen Asset Recovery Initiative and other relevant initiatives. In this regard, we urge as a matter of priority all States that have not yet done so to consider becoming parties to the International Convention for the Suppression of the Financing of Terrorism, and call for increased cooperation with the same objective."

5. Paragraph 25 of the Doha Declaration deals specifically with tax treaties when it provides that:

"Bilateral investment treaties may promote private flows by increasing legal stability and predictability to investors. It is important that bilateral investment treaties, as well as tax treaties and other tax measures to facilitate foreign investments, take into account regional and multilateral cooperation, including at the regional level. We acknowledge the importance of supporting capacity-building in developing countries aimed at improving their abilities to negotiate mutually beneficial investment agreements. It is important to promote good tax practices and avoid inappropriate ones."

III. Conference on the World Financial and Economic Crisis and its Impact on Development

6. The Conference on the World Financial and Economic Crisis and Its Impact on Development was held at United Nations Headquarters in New York from 24 to 30 June 2009. Paragraphs 38 and 39 of the outcome document of the Conference (General Assembly resolution 63/303, annex), provide as follows:

"We emphasize the need to ensure that all tax jurisdictions and financial centres comply with standards of transparency and regulation. We reiterate the need to further promote international cooperation in tax matters, including within the United Nations, inter alia, by promoting double taxation agreements. Inclusive and cooperative frameworks should ensure the involvement and equal treatment of all jurisdictions. We call for consistent and non-discriminatory implementation of transparency requirements and international standards for exchange of information.

"Illicit financial flows are estimated to amount to several times global official development assistance and have a harmful effect on development financing. Measures to enhance regulation and supervision of and transparency in the formal and informal financial system should include steps to curb illicit financial flows in all countries. Improving the transparency of the global financial system also deters illicit financial flows, including to international financial centres, and enhances the ability to detect illicit activities."

7. Paragraph 56 of the outcome document states:

"We request the Economic and Social Council:

..."

(c) To examine the strengthening of institutional arrangements to promote international cooperation in tax matters, including the United Nations Committee of Experts on International Cooperation in Tax Matters;"

IV. Conclusion

8. It is currently expected that the issue of strengthening international cooperation in tax matters, referred to in both the Doha Declaration and the outcome document of the Conference on the World Financial and Economic Crisis is likely to be considered in some form by the Economic and Social Council at its resumed substantive session in New York, possibly in September or October 2009.

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Committee of Experts on International Cooperation in Tax Matters
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Item 6 (k)
Discussion of substantive issues related to international cooperation in tax matters: transfer pricing, including a manual and checklist for developing countries

Transfer Pricing Practical Manual for Developing Countries

Note by the Secretariat*

Summary

The present note summarizes progress towards a United Nations Transfer Pricing Practical Manual for Developing Countries, and the objectives and guiding principles behind that work. A draft outline of the Manual is annexed for discussion by the Committee (the annex is being circulated without formal editing and in the original language of submission only).

* The views expressed in the present paper should not necessarily be taken as representing the views of the United Nations or the United Nations Tax Committee.

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I. Introduction

Tax treaty process and a subgroup

1. At the fourth annual session of the Committee of Experts on International Cooperation in Tax Matters, the proposed United Nations Transfer Pricing Practical Manual for Developing Countries was noted.[1] The work arose from feedback to the Secretariat about the lack of clear and relevant guidance for developing countries on the issues of the policy and administrative aspects of applying transfer pricing analyses to some of the transactions of multinationals.

II. 2008 Amsterdam Meeting

2. An Ad Hoc Expert Group Meeting on Transfer Pricing: A Discussion of the Practical Issues for Developing Countries was organized by the Financing for Development Office of the United Nations Department of Economic and Social Affairs and held on 27 and 28 August 2008 at the International Bureau of Fiscal Documentation headquarters in Amsterdam.[2] Twenty-two experts participated in the meeting, comprising government officials, private practitioners, academics and non-governmental organizations (NGOs) from both developed and developing countries.

3. At the meeting, it was noted that the proper treatment of transfer pricing is a particular issue for the operations of multinational enterprises, since market pricing conditions are not generally applicable in such dealings, yet an approximation of such market-based pricing ("arm's length pricing") is usually called for in their affairs by tax administrations. In doing so, administrations are seeking to ensure that transfer mispricing is not used as a way of shifting profits or losses from one part of the group or company to another, as may be convenient for tax purposes from the taxpayer's point of view.

4. For example, profits might be made to appear to be earned in low or no-tax jurisdictions (thereby serving to reduce tax rates on taxable profits/incomes and associated tax obligations), and deductions/losses appear to be incurred in high-tax jurisdictions (thereby increasing allowable deductions for tax purposes), with the net effect of minimizing taxes for the group or legal entity, and in so doing, impacting on the legitimate tax revenues of different tax jurisdictions.

5. The meeting noted that:

(a) Transfer pricing is a major tax issue for both developing and developed countries, but for most developing countries there are special issues in terms of capability and information gaps in assessing transfer pricing, including the need to have effective domestic rules in place to properly address transfer pricing issues, and skilled persons and adequate information to give practical effect to such rules;

(b) It was difficult for many developing countries, just as it was for many developed countries, to strike the balance of enforcing their legitimate taxing rights while ensuring an open, transparent, investment-friendly and fair environment for

[1] See *Official Records of the Economic and Social Council, 2008, Supplement No. 25* (E/2008/45-E/C.18/2008/6), para. 80.

[2] See www.un.org/esa/ffd/tax/.

investors. The skills and informational gaps in many developing countries exacerbated these difficulties;

(c) Another difficulty was the theoretical, rather than practical, nature of much of the analysis and advice on how to address transfer pricing available to tax authorities. It was noted, for example, that although the comparable uncontrolled price method plays a very prominent part in transfer pricing theory, the comparable uncontrolled price was not actually used very much in practice — the method used was overwhelmingly the Transactional Net Margin Method (TNMM), even though this was seen in the theory as being a non-preferred method — a situation currently being reassessed within the Organization for Economic Cooperation and Development;

(d) "Profit split"[3] was another method which had proponents at the meeting, especially for dealing with issues such as the transfer of intangibles;

(e) Lack of comparable data for calculating costs or resale prices of goods and services is a serious problem in many developing countries. Some developing countries used data extracted from developed country databases, such as from European and United States sources, but others took the view that that could be problematic, because the market conditions, including geographical or locational factors (such as "locational savings"[4]) would be so different. Customs data were generally obtained at a lower cost, but needed sophisticated analysis to assist in auditing taxpayers, and still remained only one part of a solution;

(f) The use of different methods in transfer pricing analysis, such as the comparable uncontrolled price, cost plus, TNMM and profit split methods, could give different results, sometimes significantly different, and there was currently only limited, and often overly theoretical guidance on the question of whether one method or the other was appropriate. The administrative difficulties in applying the methods, especially in developing countries, were often not fully taken into consideration;

(g) Price alone could be misleading, as a comparison of prices did not itself reveal what might be different cost structures, such as in sales or marketing, and therefore what would constitute "arm's length" margins. One suggestion was that the UN might have a role in giving guidelines about what were, on their face, acceptable margins on different categories of products.

6. The meeting noted that targeted but non-prescriptive guidance could greatly assist in dealing with the situation, and that, to that end, the United Nations could play a useful role in preparing a practical manual on transfer pricing for policymakers and administrators in developing countries, including a checklist or checklists of issues for consideration, and flowcharts to aid in comprehension. Such a "toolkit" would assist in understanding, prioritizing, sequencing and addressing such issues.

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[3] This method is often used when businesses are too integrated to allow for separate evaluation, and profit derived from the activity is split. The split is based on the level of contribution of each of the participants.

[4] Where there are savings due to the location (such as reduced production costs or the lower cost of information technology services in some developing countries as compared to developed countries), the issue is whether the savings should be treated as accruing not just to those who purchase the goods or services, but also to those providing the goods or services.

III. Approach taken in the Manual

7. The Manual would incorporate a step-by-step approach to be used by developing countries tax policymakers and administrators for, among other items:

- Understanding the basic issues involved in transfer pricing, including the arm's length standard commonly used to analyse such issues, and the methods of addressing arm's length ranges most commonly followed in the case of different industries and situations
- Drafting transfer pricing legislation, including aspects of the domestic legal framework such as the definition of "related parties" and requirements as to information retention and provision, and penalties — recognizing that any such legislation must be suitable for, and adapted to, the local environment
- Setting up transfer pricing units, including the role of those with legal, economic, accounting and other skills, the relationship to audit teams and to legal advisers, "tax culture" issues, and the relationship between tax authorities and taxpayers (although it was recognized that such issues needed to be addressed more generally than simply in the context of transfer pricing)
- The identification and use of relevant databases, including issues involved in extrapolating non-local material to draw conclusions relating to the local market
- Simplified strategies for identifying arm's length and non-arm's length transactions that are consistent with the underlying themes of the arm's length principle
- Compliance strategies for transfer pricing, including for different sized enterprises
- Identifying where further information is required, and how it can be obtained
- Information that should be provided to taxpayers to assist compliance
- Identification and discussion of some "red flag" issues, such as in the context of addressing contract and toll manufacturing, the identification, ascertainment of ownership and valuation of intangibles, corporate restructures and transfer pricing issues in the context of the provision of services within companies and groups
- The possible role of "locational savings" in transfer pricing analysis
- The role of the views of other countries in transfer pricing (avoiding double taxation) and the use of dispute resolution mechanisms
- The role or otherwise of exchange of information in transfer pricing investigations, including the practical issues such as the delay such a process often involves, the language issues, and possible alternatives, such as exchange of information as part of mutual agreement procedures
- The relationship with customs valuation issues, with suggestions towards developing an integrated approach
- The relationship with thin capitalization issues

- The possible use of safe harbours[5] and the like to more effectively use limited audit capabilities
- A glossary of terms used in the field of transfer pricing.

IV. Since the Amsterdam meeting

8. There has been widespread acceptance among relevant stakeholders, including governmental representatives, civil society and business that clear, practical and technically sound work in this area is to the benefit of all stakeholders in the system.

9. The secretariat has been consulting informally as to the structure of the Manual, looking to some existing Manuals and books on transfer pricing and working with experts, who have been very generous in giving their time and expertise to this area of work. Such processes have been necessarily slow but deliberate.

10. Many of the contacts in this area, from government, academia and the private sector have been asked to begin helping with drafting, and some sample chapters will be available for the annual session.

11. The assistance of the South-South Sharing of Successful Tax Practices Project[6] in assisting this work is particularly acknowledged, especially in identifying successful developing country practices that may assist other developing countries in addressing transfer pricing issues.

V. Guiding principles in drafting the Manual

12. There are a number of guiding principles for drafting the Manual as follows:

- The writing should be as simple and clear as the subject matter permits
- Although the Manual may be translated at a later date, it will first be drafted in English, with a style adapted to the fact that this will not be the first language of most users and is only one of the six official United Nations languages. The aim is to use a simple and crisp style
- The "value add" of the Manual is to be its practicality — addressing real issues for developing countries, so it should reflect the realities, and can usefully point out differences between the reality and the theory of transfer pricing

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[5] Defined by the IBFD *International Tax Glossary* as follows: "A safe harbour may be defined as an objective standard or measure, such as a range, percentage, or absolute amount, which can be relied on by a taxpayer as an alternative to a rule based on more subjective or judgmental factors or uncertain facts and circumstances. A safe harbour cannot normally be used to the disadvantage of a taxpayer. ..."

[6] This is a project undertaken by the Special Unit on South-South Cooperation of the United Nations Development Programme (UNDP), in close cooperation with the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat and two NGOs: the New Rules for Global Finance Coalition and the Tax Justice Network. It is designed to enhance cooperation among developing countries on tax matters by sharing experiences, and also to help identify areas where cooperation among developing countries needs to be enhanced to ensure that international tax norms are shaped by developing country perspectives, experiences and realities in their development and application.

- It needs to be geared to the inevitable limitations in some country's administrations, and deficits in information and skills that many countries suffer from in this area. Issues of capability, focus and efficiency in dealing with limited resources should, in particular, bear strongly on the approach taken in the Manual

- Practical examples relevant to developing countries will be especially useful. The concepts of "possible red flag issues" and of flowcharts discussed at the Amsterdam meeting are of great potential in terms of practical benefit, though it is recognized that they need to be carefully contextualized and explained (like the Manual itself), so as not to mislead

- This project is related to the work of the Committee, with other partners, on South-South Sharing of Successful Tax Practices, and in that spirit, input from developing countries' experts is particularly sought, all with different experiences in the area. The Committee will be following up further leads in developing countries, or with developed country experts with special knowledge of developing country issues and priorities

- Finally, a "life cycle" approach has informed this work — what suits a country at the beginning of its transfer pricing journey will not usually be right for it later, and vice versa.

VI. Next steps

13. A copy of the draft outline of the Manual is attached as the annex to the present document. While this will be considerably refined as the project develops, it forms a basis for comment and for developing initial drafting for the Manual.

14. At the time of writing of the present note (August 2009), the first drafts were awaited for discussion. They will be submitted to the Committee as part of the consultation and refinement process. The Committee will continue to work closely with networks of governmental, academic, business and practitioners to refine and develop chapters of the Manual, and will explore partnerships to speed up that work and work towards an online, hyperlinked version.

Annex

Transfer Pricing Manual

for

Developing Countries

2009 Draft Concept[1]

Ver 2

1 This draft should not be taken as representing the views of the United Nations or its Secretariat or of the UN Committee of Experts on International Cooperation in Tax Matters. The document draws on various publicly available materials from tax authorities and others and from the input of the Ad Hoc Experts on Transfer Pricing organised by U.N. Department of Economic and Social Affairs Financing for Development Office, August 2008. [N.B. *authors and others assisting will, of course be acknowledged appropriately*]

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Introduction and Purpose

This Manual is intended to be used as a point of reference by tax administrations to address, in a fair and informed manner, the complex matters that may arise when dealing with transfer pricing issues. It is only a guide to some possible avenues of enquiry and approaches, and must be considered in the context of a specific country's legal requirements and business practices. This Manual is designed especially to respond to the needs of developing countries and draws on, in particular, transfer pricing experiences from these countries.
This Manual is premised upon the application of the arm's length standard which determines whether the prices between parts of a multinational enterprise (MNE) properly reflect the functions and assets of, and the risks incurred by, the local part of the MNE. It is acknowledged that there is an issue of whether the arm's length standard is always an appropriate one, especially for developing countries, and whether alternatives approaches need to be considered. Whilst the importance of this issue is acknowledge and will be discussed later, it is not the central theme of this manual. It is intended to focus on the most effective, efficient and transparent ways of applying internationally accepted transfer pricing concepts and rules.

In view of the current widespread acceptance and usage of the "**arm's length standard**" (or "arm's length principle" ALP), included in the UN Model Tax Convention (UN MTC), and the benefit, in avoiding double taxation, of common approaches across countries, this Manual addresses currently accepted approaches of applying this standard in a developing country context. The larger issues of alternative approaches to addressing transfer pricing question is left for separate consideration as an important but parallel issue which is merely informed by the content of this manual.

The issues addressed and suggestions made in this Manual draw widely upon guidance made available by tax authorities and others experts, as well as relevant publications. It is envisioned that in a later version of this document there will be more hyperlinks to relevant public documents available on the internet, and more extensive direct citation. The Manual remains a practical document, however, not an academic treatise.
This Manual acknowledges the importance of investment to the development plans of most countries, and the importance to most developing countries, therefore, of an attractive investment climate. It also recognises, however, that such a favourable investment climate is entirely consistent with a robust but fair defence of revenues properly due to a country, in accordance with its law. It also recognises the advantages to business interests of a thoughtful, targeted, transparent, service oriented and not unduly burdensome and costly approach by tax administrations to the taxation of activities of investors, including multinational enterprises (MNEs) in their jurisdiction.

At this stage the Manual does not deal with the special case of banking in any detail. The Manual also does not separately address issues of branches and permanent establishments, nor deals with the Mutual Agreement Procedure (MAP) in any great detail, although the MAP is frequently relied on in transfer pricing cases, it has a broader application. These subjects may either be addressed in a later version of the Manual, or may be the subject of special specific guidance.

Chapter 1: Basics of Transfer Pricing

What is Transfer Pricing

"Transfer pricing is the area of law, accounting and economics that is concerned with ensuring that prices charged between associated enterprises [such as companies in the same group] for the transfer of goods, services and intangible property are in accordance with the arm's length principle. Transfer pricing principles may also be applied in the context of transactions – or dealings – between different parts of a single enterprise, e.g. between a head office and permanent establishment and between different permanent establishments of the same enterprise."[2]

….. [More explanation plus examples]
[including addressing issue of whether the reference to "pricing" can be misleading]

Transfer Pricing and the UN and OECD Model Tax Conventions

- *History*
- *Relevance for Developing Countries*
- *transfer pricing and double taxation - the role of the UN and OECD Double Tax Conventions and treaties based upon them*
- *the role of the OECD Transfer Guidelines OECD Transfer Pricing Guidelines and their relevance to treaties based on the United Nations Model Tax Convention?*

Transfer Pricing as an area of Taxation Law

- *Relationship to other domestic and international issues*
- *The relationship to other tax laws*
- *Relationship to customs issues (brief outline of issue – differences)*

The Arm's Length Standard

Transfer pricing is important because of its impact on the allocation of profits and losses (and therefore the corresponding tax bases) of different parts of a multinational group across different jurisdictions. If the pricing of transactions between parts of an MNE located in different jurisdictions is incorrect, a jurisdiction may be denied its legitimate tax revenues. However, if jurisdictions take different views on a transfer pricing matter, the MNE involved may be subject to unrelieved economic double taxation.

A common concern is that dealings between parts of an MNE might be manipulated to shift profits to low tax jurisdictions, with losses and attendant deductions, moved to or retained in high tax jurisdictions. Transfer pricing and the arm's length standard seek to counter such practices, however the scope of transfer pricing is however broader than just anti-avoidance, and is as applicable to dealings without tax motivation.

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2 IBFD International Tax Glossary (words in parentheses added)

The arm's length standard is internationally widely accepted as the preferred basis for determining the transfer prices for transactions between related parties, and is found in the UN and OECD Model Tax Conventions. This Manual seeks to assist developing countries by exploring what the application of this standard means in practical terms, and how it can be most effectively administered within applicable resource and other constraints.
An important initial question for any country is: has the arm's length standard been accepted as the governing principle in that country? In most cases, the answer will be, "at least for the present, yes". In theory, the wide acceptance of the arm's length standard should minimise the possibility for economic double taxation, as other countries are more likely to accept an arm's length adjustment and give relief from double taxation by way of corresponding adjustment.

According to the arm's length standard, a transfer price is acceptable if a transaction between related parties takes place at an arm's length price. With an arm's length price quite simply defined as the price which would have prevailed if the transaction had taken place between independent enterprises acting under the same or similar circumstances.

In applying the arm's length standard there is a comparison of "conditions" made or imposed between related parties with those which would be made between independent enterprises. This comparison is undertaken in order to determine whether these conditions have affected the prices used, and hence whether that a transfer pricing adjustment needs to be made - recalculating the profits which would have accrued to the enterprise in the absence of such conditions, or adjusting the conditions themselves to replicate those which would be made between independent enterprises.

Under Article 9 of the UN and OECD Model Tax Conventions, two enterprises are related parties with respect to each other if (in general) one of them participates directly or indirectly in the management, control or capital of the other enterprise; or they are under common control. This includes the relationship of separate legal entities in a group, such as a subsidiary and its parent company, or two parts of a single legal entity, being a branch (permanent establishment) and head office. Domestic legislation will often contain a more prescriptive definition of related parties, for the purposes of application of domestic transfer pricing rules.

In some countries, even without specific transfer pricing rules, the administration is empowered to disregard certain transactions altering the incidence of tax, and make adjustments to counteract the effects of such transactions. These provisions often allow the application of arm's length methodologies and the computation of an arm's length price or range.

Introduction and Explanation of the Annexed Flowcharts

- *There are several possible flowcharts:*
  - *the transfer pricing process for price setting or evaluation by a multinational*
  - *Flowcharts for different industries might also be possible.*
  - *A flowchart of the tax administration process (starting with identification of taxpayers – related party transactions – risk assessment etc).*
  - *A flowchart on possible documentation requirements [at least in one sample developing country with successful practices, might also be useful]*

Chapter 2: Establishing Transfer Pricing Capability in a Tax Administration

The Relationship Between Policy and Administration Issues

- *include issues of coordinating cross-ministerial responsibilities*

Setting up Policy Capacity

- .....

Assessing Administrative Capability

- *Assessing the level of development/ capability of the Tax Administration:*
  - *level of education and expertise*
  - *legal environment,*
  - *tax treaties (exchange of info)*
  - *availability of information in country/tax administration*

Setting up a Transfer Pricing Unit

- *Types of structure:*
  - *Centralised*
    Advantage: coordination, easy in start-up phase, fast building up of knowledge
    Disadvantage: risk of being in ivory tower

- *Decentralised*
  Advantage: short lines of communication with tax inspectors, easy spread of knowledge, combined industry and TP knowledge, more fit for later phase
  Disadvantage: coordination problems

- *Elements of organisation*
- *The legal framework*
- *Administrative policy making*
- *Coordination*

- *Staffing*
  - *Economists*
  - *Lawyers*
  - *Accountants*
  - *Auditors*
  - *Database-experts*
  - *Project management skills*
- *Budget and Funding*
- *Also: management information, registration/recording of TP-cases and adjustments*

Chapter 3: Policy and Administration Considerations

Overview

- *Transfer Pricing Phases/Stages/Life Cycle of the tax administration [Setting the scene]*
- *Influence of stages of an organisation on the organisation, but also on topics to be targeted and knowledge to be developed. For example: in first stage start with small number of industries of key importance and tackle most common problems. Also relevant for legislation- for example: start with general legislation and not with trying to tackle very complex issues.*
- *Elements discuss in this chapter are processes in the organisation. They could be structured in separate units or could be combined. At least the interfaces and interrelations between the elements should be taken care of. Not in all phases all the processes should be equally important (e.g. in start-up no APA)*

- *Transfer Pricing for Small and Medium-sized Enterprises (SMEs) – special issues? Streamlined compliance and administration?*
- *Acceptance and understanding of arm's length principle in domestic law*
- *Domestic Definition of related parties (who is covered legally, and in practice)*
- *Documentation and tax filing requirements*
- *Approach to comparability (process etc)*
- *Determining ALP (methods etc)*
- *TP-database use*
- *Dispute resolution and avoidance (including APAs, MAP etc)*
- *Adjustments (types: primary, secondary, corresponding) and penalties (types/scope)*
- *Attribution of profits to a PE – related issue*
- *TP-intelligence (detection of cases, knowledge centre etc)*
- *TP education/instruction (refer to heading below)*
- *Links to stakeholders – business and others*
- *Specific Country practices – [would be best integrated into the topics above rather than as a free-standing list, with links to more detailed "local explanations" where appropriate].*

Compliance Strategies and Policies

- *More or less the caveat: think before you leap.*
    - *Specific Focus:*
        - *Decide whether to set up coordination or separate TP groups per industry*
        - *Analysis of the importance of industries in the country - develop knowledge on top% of industries.*
        - *Develop solutions (administrative, legislative etc) for typical problems (see for example Mexican example of dealing with maquiladores)*
    - *Internal process: role of TP-unit - Options (also depending on life cycle):*
        - *advice only*

- *compulsory consultation*
- *TP-unit will take over case handling*

- *Case selection process, some options:*
  - *risk rating system (refer to chapter on risk assessment)*
  - *random*
  - *based on internal information*
  - *building up knowledge of your most important clients (international structure, global stream of transactions, high level idea of functions performed, financial statement analysis)*

- *Additional issues and attitude-shifting:*
  - *retrospective: audit focused on adjustments with risk of lot of MAPs (especially with transactions with large number of countries)*
  - *prospective: adjustments limited to clear cut cases, in other situation strive for good future solution together with taxpayer. High level of transparency: TP is not exact science. Open attitude towards taxpayer may help a lot in reaching a solution. Look to APAs program in time.*

- *Developing transparency as a value– relationship of regulation and transparency.*
- *Contacts with TP-consultants - A strategy could be to have informal meetings periodically to discuss both process and substantive issues*
- *Voluntary Compliance – options for MNEs*
- *SME and Large Taxpayer Approach (distinguish – thresholds?)*
- *Simplified Approaches*
  - *Optional Safe Harbours? Pros and cons in policy and administration terms –including treaty issues and potential economic double taxation if not in accordance with ALS*
  - *Fixed Rates or Ranges of Return*
    - *General*
    - *Industry Specific*
    - *Transaction Specific*

Compliance Programs

- *Documentation requirements – a variable geometry (SMEs/ MNCs)?*

- *Filing requirements, Questionnaires and Risk Rating/Statistical Tools*
- *Enforcement powers*
- *Tax inspectors (general)*
- *TP-audit - Introducing the idea of an iterative process (e.g. risk analysis, high level functional analysis, initial interview, initial audit (high level), thorough audit etc):*

  i. *Initial risk/documentation review*

     - *Criteria for Selection – (see compliance strategies and policies above)*
     - *Industry Approach*

  i. *Selecting Cases to proceed to Audit*

     - *Criteria for Selection*

  ii. *Undertaking an Audit*

     - *Timing, process etc*

  iii. *Country specific practices*

     - Benchmarking/Pre-determined Rates of Return (e.g. Brazil)

  iv. *Typical cases – examples*

  v. *Specific industries - examples*

Transfer Pricing Adjustments and Penalties

- *Refer to specific chapter covering this topic, but provide summary of:*
- *Use/type of adjustments*
  - *Primary*
  - *Secondary*
  - *Corresponding*
- *Penalties*
  - *Base - shortfall (tax or taxable income)?*
  - *Documentation*
  - *Taxpayer size/category*

Dispute Resolution and Avoidance

- *Refer to specific chapter covering this topic, but provide summary of concepts/tools:*
  - *Settlement*
  - *Litigation*
  - *Procedure for MAP access – relationship to domestic law rights*
  - *Competent authority - Some "best" practices to be found at OECD site (MEMAP) – relevance to developing countries explored.*
  - *Advance Pricing Agreements (APAs)*

Education and Information Strategies

- *Internal:*
  - *Organisation of education (in-house or external - e.g. international organisations)*
  - *Diversification of education: experts, TP-network, general tax inspectors and industry experts. Focus different defending on moment in lifecycle (start with small group of experts etc)*
  - *Strategy: focus on practical education directly followed by practical application in practice to increase effect, instead of educating large groups that don't use the material in practice.*
  - *Education not only on theoretical framework but also on audit strategy, practical considers, industry specific etc*
- *External*
  - *working with stakeholders, tax culture issues and the relationship(s) between informational strategies and compliance*
- *Sources of Information*

Chapter 4: Legal Framework

Domestic Approaches

- *Definition of related parties*
  - *Article 9*
  - *Domestic law (with examples)*

- *Types of transfer pricing rules:* Legislation, Regulations, Rulings, and other Guidance
- *Discuss use of different types to achieve different objectives*

Tax Treaties

- *Limits Domestic Law*
- *Scope of treaty (i.e. can a TP adjust be made under treaty in absence of domestic legislation?)*

Legislative and Regulatory - Country Specific Examples

- *Relevant elements (and common points) of Country Transfer Pricing Legislation and Regulations [more to be added – this will have to be fairly basic to be manageable, especially with updates occurring – possibly more material in appendices]*
  - *Argentina*
  - *Australia*

    Australia has specific transfer pricing legislation, found in Division 13 of the Income Tax Assessment Act 1936. Division 13 prescribes the application of the arm's length standard, but does not have automatic application as it is applicable at Commissioner's discretion. There are however significant penalties for taxpayers who do apply the arm's length standard voluntarily.
    The application of Division 13 by the Commissioner merely requires; a supply or acquisition of property (defined to include services) under an international agreement (broadly defined) between two or more parties; that the Commissioner be satisfied that the parties to the transaction were not dealing at arm's length; and, that the Commissioner exercise his discretion to apply it. Notably, the application of Division 13 does *not* require the parties to be related (or associated), only that they have not dealt at arm's length.
  - *Brazil*
  - *China*
  - *Egypt*
  - *France*
  - *Germany*
  - *Hungary*
  - *India*
  - *Indonesia*
  - *Italy*

- *Japan*
- *Kazakhstan*
- *Kenya*
- *Malaysia*
- *Mexico (new rules interesting to discuss)*
- *Netherlands*
- *New Zealand*
- *Nigeria*
- *Norway*
- *Pakistan*
- *Singapore*
- *South Africa*
- *Thailand*
- *United Kingdom*
- *United States of America*

  > US Code of Federal Regulations (Transfer Pricing – refer to Reg. 1482)

Guidance and Rulings - Country Specific Examples

- *Relevant elements of Transfer Pricing Guidance/Rulings/ Examples of application of methods, country rulings etc*

Australia

Under its public ruling program, the Australian Taxation Office (ATO) has released numerous rulings on transfer pricing and related subjects. These rulings are binding on the Commissioner insofar as they are relied on by, and are applicable to, a taxpayer. The topics covered by these rulings include: Transfer Pricing Methodologies; Intra-Group Services; Cost Contribution Agreements; Loan Arrangements; and, a number of other practical and interpretive matters.

> Australian Taxation Office: Transfer Pricing Rulings and Determinations

Notably, the ATO has issued public ruling TR98/11, which provides comprehensive practical guidance on the preparation of transfer pricing documentation, and the process for setting and reviewing international transfer prices, for Australian tax purposes.

> Australian Taxation Office: Taxation Ruling TR 98/11

In addition to the rulings and determinations, the ATO has also issued a number of transfer pricing specific papers, covering issues ranging from a basic introduction to transfer pricing concepts and risk assessment through to more specific issues such as marketing intangibles. The ATO continues to be active in this area, recently releasing a draft paper on business restructures (May 2007) and a draft paper on intra-group finance guarantees and loans (June 2008).

> Australian Taxation Office: Transfer Pricing Papers

Relevant Case Law

Non Transfer Pricing Considerations

- *Description of the issues and caveat to regard cases not only from one perspective, but also the other issues (for example intensive TP audit of a cases where all operational profit is eroded by interest is not very valuable):*
    - *Taxing Natural Resources*
    - *Thin Capitalisation*
    - *Anti-Earning Stripping Rules*
    - *Erosion of the Tax Base*
    - *CFC Rules*
    - *Permanent Establishment (existence)*
    - *General Anti-Avoidance Rules*

Chapter 5: Transfer Pricing Analysis in Practice

Introduction

Flowchart

Functional Analysis

- *Introduction (purpose and importance)*
- *Fact finding process*
- *Analysis of functions, assets and risks*
- *Industry analysis*
- *Entity classifications*

Comparability

- *Determination of comparable companies and performing comparability analysis (determines an arm's length return for the functions assets and risks attributed). Dealing with outlying companies – highly profitable/ loss-making*
- *The arm's length "range" – arithmetical mean vs. inter-quartile range or other statistical tools*
- *How comparable are proposed comparables? Possible differences on the basis of:*
  - *Quantity differences*
  - *Geographical differences*
  - *End-use differences*
  - *Quality / characteristic differences*
  - *Difference in the lifecycle of the product*
  - *Differences in terms of trade*
  - *Different channels of distribution*
  - *Other relevant economic differences*
- *Location savings – how does the concept operate – how are they valued and to whom do they belong [Refer to special issues chapter]*
- *Market Penetration strategies and transfer pricing (e.g. reduced prices, higher marketing costs etc) [Refer to special issues chapter]*

Corporate Level Issues and Understanding Corporate Compliance Strategies

- *Related Party Dealings*
- *Associate Enterprises/Related Parties – definition and identification*
- *MNEs Transfer Pricing Global Policies and Strategies*
- *Financial*
  - *Profit Level Indicators*
    - *Link to materials such as the IRS APA guide*
  - *Ranges*
    - *Link to materials such as the IRS APA guide*

Transaction Specific Issues

- *[Introduce/highlight issues, but elaborate in later chapter]*
- *Intra-Group Services*
- *Intra-Group Finance*
- *Intangibles*
- *CCAs*

Industry Specific Issues

- *Oil & Gas*
    - *Resource Tax Regimes*
- *Mining*
- *High technology industries*
- *Services sector*

Chapter 6: Transfer Pricing Methods

Introduction

- *Use of Methods*
- *Selection of method(s) (how, why and use of more than one method)*
- *Is it any longer useful to think in terms of a hierarchy of methods?*

Current Methods

- *[Include examples for each method?]*
- *Comparable Uncontrolled Price (and its derivatives – CUT etc)*
- *Resale Price Method*
- *Cost-Plus Method*
- *Transactional net Margin Method*
- *Profit Split Methods*

- *Comparable Profits Method*
- *Other (i.e. modified resale price and use of any method, provided AL price)*

Alternatives

- *Global Formulary Apportionment – an introduction (alternative method for applying the ALS or alternative to the ALS?)*

Case Studies

- *[include a case study that highlights issues that may arise, i.e. Use of CPM v TNMM by two different countries]*

Chapter 7: Transfer Pricing Analysis and Methods - Special Issues

Location Savings

- *what are they and to whom do they belong (how to allocate)*

Market Penetration Strategies

Business Restructuring

Tax Holidays and transfer pricing

Accounting and Corporate Governance developments

- E.g. Fin 48
- .....

Customs valuation issues

VAT/GST/Withholding Tax Issues

Foreign Investments

Treatment of Intangibles

- *Defining & Identifying Intangibles*

- *Ownership*
    - *Legal*
    - *Economic*
- *Transfer of Intangibles*
    - *Know How*
    - *"Mixed bundles"*
- *Valuation*
- *Functions, Assets and Risks*
    - *Research & Development*
    - *Other cost contribution*
    - *Transfers and licensing*
- *Royalties Rates*

Intra-Group Services and Commodities Trading

- *Technical Services*
- *Administrative services*
- *[Practical application of methods]*
- *Administrative concessions (non-core, de minimis etc)*

Cost Contribution Arrangements (CCAs)

- *Research & Developments*
- *Other cases*

Intra-Group Finance

Chapter 8: Documentation

Introduction

- *What is it?*

- *[Developing country examples???]*
- *Burden of proof/legal requirements*
- *SME v Large Business / other thresholds*
- *PATA*
- *EU Joint Transfer Pricing Forum*
- *Documentation related penalties*

Chapter 9: Risk Assessment (RESTRICTED ACCESS? - to be determined)

Selecting Cases for initial Risk/Documentation Review

- *Criteria for Selection – see strategies & policies above*
- *Industry Approach*

Selecting Cases for Audit

- *Existence/quality of TP documentation*
- *Commercial reality check*
- *Presence of Specific transactions*

Examples of Country Specific Practices

- *Benchmarking/Pre-determined Rates of Return (e.g. Brazil)*
- *……*

Safe Harbours

- *Policy issues*
- *Tax Treaty, Corresponding Adjustment issues and Economic Double Taxation*

Administration

Chapter 10: Audit – Processes and Procedures (RESTRICTED ACCESS? - to be determined)

Strategy

Simultaneous Tax Audits

Country Specific Best Practices

Effective Use of Resources

Chapter 11: Adjustments, Disputes and Dispute Resolution and Avoidance

Introduction to dispute avoidance and resolution in a domestic and international context

Transfer Pricing adjustments, including corresponding adjustments

- *Primary*
- *Secondary*
- *Corresponding (who/when and Article 9(2))*

Penalties

The Mutual Agreement Procedure (MAP) under tax treaties

Settlements and alternative dispute resolution

The Role of Courts and Tribunals in Transfer Pricing Dispute Resolution

- *The role of courts and tribunal*
- *Dealings with taxpayers, administrators and possible impact on policy makers*
- *The domestic law setting*

- *The international context*
- *Dealing with skilling up and consistency issues*
- *Dealing with workloads*
- *Are there possibilities for greater cooperation or at least greater sharing of experiences internationally?*

Advance Pricing Agreements (APAs) – policy and administrative considerations

Developing an APA program – practical considerations

Chapter 12: Government to Government (RESTRICTED ACCESS? - to be determined)

- *Governance*
- *Enforcement Powers*

Chapter 13: Sources of Information

Relevant Bodies (with hyperlink where available):

- AATA – *Association of African Tax Administrators*
- ATAIC – *Association of Tax Authorities of Islamic Countries*
- CATA - *Commonwealth Association of Tax Administrations*
- CIAT - *The Inter-American Center of Tax Administrations/Centro Interamericano de Administraciones Tributarias*
- COTA - *Caribbean Organization of Tax Administrators*
- CREDAF - *Centre de Rencontres et d'Etudes des Dirigeants des Administrations Fiscales*
- EUJTPF – *EU Joint Transfer Pricing Forum*
- IBFD – *International Bureau of Fiscal Documentation*
- IOTA – *Inter-European Organisation of Tax Administrations*

- OECD – *Organisation for Economic Co-operation and Development*
- PATA – *Pacific Association of Tax Administrations*
- PITAA – *Pacific Islands Tax Administrators Association*
- SADC – *Southern African Development Community*
- SGATAR – *Study Group on Asian Tax Administration and Research*
- *[others]*

Research

- .....

Chapter 14: Training and Capacity Building Resources

South – South Experience

CATA, CIAT, CREDAF, IOTA, SGATAR, SADC

UN - Related

OECD

Organisation for Economic Co-operation and Development

IMF, World Bank etc

IBFD

- Open Courses
- In-house Courses
- On-line Courses

Funding

APPENDICES

Glossary of Terms

Frequently Asked Questions (FAQs)

Checklist [and possibly also a flowchart] for a transfer pricing set-up

Checklist of possible transfer pricing issues – General

- *Checklist for (non-financial) services industries*
- *Checklist for financial services industries*
- *Checklist for commodities trading*
- *Checklist for Pharmaceuticals industries*
- *Checklist[s] for Oil and Gas/ Mining industries*
- *Checklist for transactions involving intangible property*
- *Checklist for telecommunications Industry*
- *Checklist for the Media and entertainment*

Table of main differences and possible uses of different Methods

Flowchart of a typical transfer pricing scenario (with non-typical extensions)

Current Databases – a Survey

Checklist [and possibly also flowchart] on documentation

Bibliography